telecommunications market."[50] The Commission need not adopt any new cost allocation rules to meet this Section 271 requirement. Price regulation alone is sufficient to protect the ratepayers of price cap carriers. Part 64 procedures are a redundant and unnecessary protection against cross-subsidy for price cap carriers.

In SBC's Comments in CC Docket No. 96-149, SBC urged the Commission to heed the deregulatory objectives of the 1996 Act and to focus its nonaccounting safeguard implementation efforts on the express terms in Section 272, not an expanded set of requirements the Commission was not directed to adopt.[51] Similarly, as this review of the specific requirements of Sections 260 and 271 through 276 reveals, the 1996 Act does not require the adoption of more stringent accounting safeguards. In fact, the only direct reference to them is in the reference to nonstructural safeguards for transfer of payphones to nonregulated status. Given that the specific provisions do not require any particular accounting safeguards, the Commission should apply the general provisions of the 1996 Act that require the Commission to take a deregulatory approach and to reduce the burden of regulation no longer necessary in the public interest, especially where it is supplanted by less restrictive alternatives such as price cap regulation.

B. The Commission Should Not Adopt Any Special Cost Allocation Rules for Incidental InterLATA Services.

The Commission asks whether it should develop special cost allocation rules for incidental interLATA services and out-of-region interLATA services. The Commission suggests

[50] 47 U.S.C. § 271(h).

[51] SBC Comments, CC Docket No. 96-149, filed August 15, 1996 at 2-4 & passim.

two alternatives: (1) create a third category of costs in LECs' cost allocation manuals ("CAMs") for these "other" regulated costs; or (2) treat these "other" regulated costs as if they were nonregulated activities for Title II accounting purposes.[52] In view of price cap regulation and existing Part 64 procedures, it is not necessary to make any change at all in the cost allocation rules for incidental interLATA services.

Under existing cost allocation rules, if a nonregulated activity uses an incidental interLATA service, then the nonregulated activity will be charged with the costs of that incidental interLATA service. Some of the "incidental interLATA services" listed in Section 271(g) are nonregulated, others are regulated. If the service furnished by the BOC to the public is a nonregulated activity, such as Title VI video programming, then the costs of the incidental interLATA facilities will be allocated to that nonregulated activity under existing Part 64 CAM procedures, without the necessity of any change in the rules. If the underlying incidental interLATA facilities are used to provide tariffed services, such as Title II video programming transmission, then any BOC nonregulated activity that utilizes that transmission service would be charged the tariffed rate.[53] Consequently, it is not necessary to change Part 64 cost allocation rules for incidental interLATA services.

The interLATA facilities permitted by Section 271(g) are incidental to one or more of the regulated or nonregulated activities listed in Section 271(g). It would be improper to treat all such incidental interLATA services as if they were nonregulated, as the NPRM suggests,

---

[52] NPRM, ¶39.

[53] Joint Cost Recon Order, ¶15 (explaining the accounting procedures for nonregulated activity use of tariffed services).

because a number of the activities they would support would be regulated. Signaling systems and Title II video programming are two examples of regulated use of these incidental interLATA facilities. Regulated costs of services such as these are supposed to flow through the existing Part 36 process to separate integrated plant serving multijurisdictional purposes between state and interstate. Part 36 separations rules do not have procedures to segregate certain unique regulated costs.

It is not necessary for purposes of Section 271(h) to adopt a special rule for incidental interLATA services. To the extent the service in question is regulated, price caps and tariffing requirements will protect ratepayers of such regulated services.[54] To the extent incidental interLATA services are used for nonregulated activities, the proper amount of costs will be charged to that activity via Part 64.

Under current Part 64 and Part 36 regulations, the process works as a whole to assure that the total joint and common costs are treated in a consistent manner for allocation to the appropriate jurisdiction. The advent of new services is not an unusual occurrence that requires any significant change to the process, nor does it require a new procedure outside of Part 36. In fact, to contemplate a unique jurisdictional separations process for these new services outside of Part 36 would pose a considerable risk to the validity of the process as a whole, since the costs for the segregated services, in theory, would include joint and common costs that affect other state and interstate regulatory mechanisms. Using a different allocation process for such new services would all but assure that sum of the joint and common costs derived from Parts 64 and

---

[54] See, e.g., Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Second Further Notice of Proposed Rulemaking, 11 FCC Rcd 858, ¶¶18-29, 86-91 (1995).

36 would not equal the total joint and common costs on the LEC's Part 32 books. Two different allocation processes, however precise, will yield different results, that somehow would have to be reconciled in the price cap and tariff processes.

Neither of the two alternatives suggested in paragraph 39 of the NPRM is necessary or appropriate. Each alternative would fundamentally alter the existing CAM process, although to differing extremes. However, the worst of the two alternatives is the one that would require the creation of a third, separate category of costs in LECs' Part 64 CAMs. Implementation of this alternative certainly would be a "fundamentally different cost allocation approach" which would "impose substantial administrative and financial costs on the carriers."[55] The NPRM indicates that the Commission does not wish to take such a disruptive approach to cost allocation. This suggested alternative, even more than the other, would be precisely the type of fundamental change that the NPRM indicated it wanted to avoid. Aside from being disruptive, burdensome and unnecessary, this alternative would be extremely complex. For example, there would be the potential for three-way reallocations of investment and the network investment forecasting rule would become more complex than ever. Other consequences of this rule change include extensive modifications to the computer programs used by LECs to generate data and additional time reporting, data collection and special studies. Such complexity is antithetical to the deregulatory goals of the 1996 Act and must be avoided.

The NPRM indicates that, if it adopted the second alternative, it would require BOCs to reclassify as nonregulated "any regulated services other than local exchange and exchange

[55] NPRM, ¶28.

access services they provide on an integrated basis."[56] It would truly be a fundamental change in Part 64 to require the wholesale exclusion of a category of regulated services from the regulated category. If all costs other than those of local exchange and exchange access are excluded, as this NPRM alternative suggests, then Part 64 would no longer be a cost allocation system for the segregation of regulated from nonregulated costs. For example, certainly the Commission did not intend to suggest that this alternative would reclassify as nonregulated the "incidental regulated activities," listed in Section III of LECs' CAMs, such as pole/conduit leasing, bill insert services, and leasing of surplus space in buildings. Another example is billing and collection service for interexchange carriers.

C. Section 272(e) Does Not Require Any Changes to the Accounting or Cost Allocation Rules.

The NPRM asks for comment on how the BOCs should account for the access charges that Section 272(e)(3) requires them to impute to themselves in connection with their own use of exchange access in the provision of their own services. The NPRM suggests as one approach that these imputed access charges "would be directly assigned to nonregulated activities with a credit to the regulated exchange access revenue account."[57]

Section 272(e)(3) does not require any change in accounting or cost allocation rules. Instead, this provision is merely a requirement related to the pricing of a BOC's services that utilize exchange access and which requires that the access charges to unaffiliated interexchange carriers be imputed in the BOC's own retail prices. This provision does not

---

[56] Id., ¶39.

[57] Id., ¶41.

require, or even mention, changes in accounting or cost allocation rules. In effect, it only requires that the BOC include the access charges in its own internal development of the prices of services and products that utilize exchange access. Accounting and special cost allocation rule changes are not needed to determine whether a BOC is in compliance with this requirement. Instead, in the event of a complaint, the pricing of a specific service can be examined.

The NPRM's suggested method of accounting for imputed exchange access charges is different from the existing rules. Instead of recording these access charges as an expense of the nonregulated activity, as the NPRM suggests, current rules record them as a debit to the nonregulated revenue. Under the current rules, if a nonregulated activity uses exchange access, "[t]he amounts which the carrier, in effect, pays to itself for tariffed services which it has obtained for use in the provision of nonregulated products and services are credited to the appropriate regulated revenue accounts [and] [t]he amounts credited as regulated revenues are also debited to the nonregulated revenue account."[58] Since there is already a satisfactory method to account for nonregulated use of tariffed exchange access, a rule change is not necessary.

The NPRM asks for comment as to whether Sections 272(e)(3) and (e)(4) should affect cost allocation rules for those BOCs that provide interLATA services on an integrated basis. These provisions are contained in Section 272, which relates to in-region interLATA service, not incidental interLATA service. These provisions are not relevant to the incidental interLATA services that the BOCs are permitted to provide on an integrated basis. Instead, these provisions are only pertinent to the in-region interLATA services that the BOCs are required to provide through a separate affiliate pursuant to Section 272(b). The affiliate transaction rules

[58] Joint Cost Further Recon Order, ¶ 15.

are more than sufficient to assure that the costs of any interLATA or intraLATA facilities or services furnished to the in-region interLATA affiliate are appropriately allocated between the BOC and the affiliate via the tariffed charges or other applicable valuation method of the affiliate transaction rules.

The NPRM also asks whether the Commission should require BOCs that provide interLATA or intraLATA facilities or services on an integrated basis "to provide them to their own internal operations only at the same rates as those facilities or services are made available to all carriers."[59] The NPRM indicates that Section 272(e)(4) would be the basis for this requirement. Again, Section 272(e)(4) has no relevance to incidental interLATA services, and thus, would not be a proper basis for a requirement concerning the rates charged to the BOC's own internal operations or to its affiliate. That would be a tariffing or pricing, rather than an accounting, issue. Assuming *arguendo* that the interLATA service in question is required to be tariffed, then the existing cost allocation rules already contain the appropriate method of handling tariffed charges.

Next, the NPRM asks which rate should apply to a BOC affiliate transaction when the rates for incidental interLATA services furnished on an integrated basis differ for different carriers.[60] This question also implies a tariffing issue. Assuming the incidental interLATA service is tariffed, the existence of different rates for different carriers means that there must be reasonable differences between the services provided to the different carriers which justify the differences in rates. The affiliate could subscribe to any tariff for which it is eligible and that

---

[59] NPRM, ¶42.

[60] Id.

would be the applicable charge for purposes of the affiliate transaction rules. If, on the other hand, the incidental interLATA service is not tariffed, then the prevailing price or fully distributed cost methods of the affiliate transaction rules would be used to determine the applicable rate. For example, a substantial quantity of sales of the service at a particular rate would be sufficient to substantiate a prevailing price for the service.

VII. EXISTING AFFILIATE TRANSACTION RULES ARE MORE THAN SUFFICIENT TO SATISFY THE REQUIREMENTS AND GOALS OF THE 1996 ACT.

The Commission should reach the same conclusion concerning the sufficiency of its affiliate transaction rules to satisfy the requirements of the Act as it does concerning the sufficiency of the cost allocation rules. SBC firmly believes that the existing affiliate transaction rules are more than sufficient to satisfy the requirements of Sections 272 through 274 of the 1996 Act. In addition, the existing affiliate transaction rules are more than sufficient to assure that interLATA, manufacturing, electronic publishing and other activities required or permitted to be conducted through separated operations are not subsidized at the expense of ratepayers of regulated services. In actuality, as in the case of the cost allocation rules, the affiliate transaction rules are not necessary to prevent cross-subsidy at the expense of ratepayers of price cap LECs. For price cap LECs not subject to sharing obligations, the affiliate transaction rules are a redundant safeguard against such cross-subsidy and provide more protection than is necessary. The 1996 Act does not require the Commission to adopt more stringent or burdensome affiliate transaction rules. It would be entirely consistent with the 1996 Act for the Commission to continue to rely upon the existing affiliate transaction rules, to the extent still necessary in view of price cap regulation, as the method of protecting ratepayers of regulated services and competition. The reasons for this conclusion concerning the sufficiency of the affiliate transaction rules are the same as those explained above in the analysis of the sufficiency of the cost allocation rules under the 1996 Act. The 1996 Act does not require any additional or more stringent affiliate transaction rules. On the contrary, if anything, the 1996 Act requires deregulation and simplification of rules such as these, especially to the extent that they are not necessary in the public interest.[61]

The affiliate transaction rules have been applied, tested and affirmed through numerous Commission orders and in actual use for over eight years. The Commission has repeatedly confirmed the sufficiency of the affiliate transaction rules.[62] Nothing has occurred in the years of history of the affiliate transaction rules that would justify substantial changes in these rules, except to the extent that price cap regulation and competition reduce the significance of these rules in achieving their purposes. These rules were found adequate in CC Docket 86-111, refined in numerous CAM review orders since 1988 and reaffirmed as working well in the Computer Inquiry III Remand Order in 1991. The Commission has comprehensive procedures to audit and enforce these rules and has done so repeatedly. Precisely because these rules have been in effect for several years, they are firmly embedded in the procedures and relationship

---

[61] 47 U.S.C. §§10, 11.

[62] See, e.g., Telephone Company-Cable Television Cross-Ownership Rules, Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, 10 FCC Rcd 244, ¶¶161, 166, 179-182 (1994); Computer III Remand Proceedings; Bell Operating Company Safeguards and Tier I LEC Safeguards, CC Docket No. 90-263, 6 FCC Rcd 7571, 7577 (1991) ("Computer Inquiry III Remand Order") ("[W]e determine that our existing cost accounting safeguards and those proposed in the Notice constitute a realistic and reliable alternative to structural separation to protect against cross-subsidy . . .."); In the Matter of Request of US WEST Communications, Inc. For a Limited Waiver of Section 22.903 of the Commission's Rules, DS 96-605, Order released April 17, 1996, ¶24; Pacific Bell Section 214 Order and Authorization, 1995 FCC LEXIS 5416, File No. W-P-C-6913 released Aug. 15, 1995, ¶115.

between each LEC and its affiliates. Those years of affiliate transaction history have been spent developing systems, reports, methods, procedures and contracts to implement the existing rules as part of the day-to-day working environment of the LEC and its affiliates. In addition, the procedural mechanisms for implementing these rules have evolved, and been fine-tuned, over the course of these years with the assistance of both internal and external auditors. Substantial modifications of the affiliate transaction rules would not only go against the grain of the existing firmly established principles, but it would also consume a great quantity of resources, which would be extremely unlikely to be justifiable, especially in today's competitive telecommunications environment.

The competitive impact of substantial modifications of the affiliate transaction rules is particularly troublesome in view of the Commission's reluctance to impose any accounting, cost allocations, or affiliate transaction requirements on any of SWBT's competitors entering from other markets, such as incumbent cable operators upgrading their cable systems to provide telecommunications services.[63]

While the NPRM tentatively concludes that the existing affiliate transaction rules generally satisfy the pertinent requirements of the 1996 Act and recognizes that adoption of a "fundamentally different approach . . . would impose substantial costs on the carriers," the NPRM nonetheless proceeds to propose significant changes to the affiliate transaction rules. These proposals to adopt different and more stringent valuation procedures constitute a

---

[63] Implementation of Sections of the Cable Television Consumer Protection Act of 1992: Rate Regulation, MM Docket No. 93-215, Second Report and Order, First Order on Reconsideration and Further Notice of Proposed Rulemaking. FCC 95-502, 11 FCC Rcd 2220 ¶¶ 106-138 (1996).

fundamentally different approach and clash with the deregulatory backdrop of the 1996 Act. They impose rather than avoid unnecessary regulation.

The basis for some of the changes proposed in the NPRM is the Affiliate Transaction NPRM[64] released almost three years ago, which proposed similar changes. The NPRM indicates that the Commission intends to consider further changes to the affiliate transaction rules in a subsequent order that would finally conclude CC Docket No. 93-251. SBC and the industry opposed the changes proposed in the Affiliate Transaction NPRM and SBC continues to oppose changes for the reasons set forth in its Comments in that proceeding.[65] SBC believes that if any further changes to the affiliate transaction rules are going to be considered, the Commission should do so in this proceeding, rather than on a piecemeal basis. Therefore, SBC recommends that this NPRM be viewed as superseding the Affiliate Transaction NPRM entirely.

VIII. THE COMMISSION SHOULD NOT ADOPT THE FUNDAMENTAL CHANGES TO THE AFFILIATE TRANSACTION RULES PROPOSED IN THE NPRM.

After disavowing any intention of making fundamental changes in the approach of the affiliate transaction rules, the NPRM proposes to do precisely that. As part of its effort to implement Sections 272 through 274, the Commission proposes to eliminate the prevailing price valuation method used for assets and services and to superimpose an additional valuation method on top of the fully distributed cost method used for services. Elimination of one of the three tiers of valuation methods for both assets and services and the addition of a duplicate valuation test

---

[64] Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transactions Between Carriers and Their Nonregulated Affiliates, CC Docket No. 93-251, Notice of Proposed Rulemaking, 8 FCC Rcd 8071 (1993).

[65] SWBT Comments filed December 10, 1993 and SWBT Reply Comments filed January 10, 1994 in Affiliate Transaction NPRM, CC Docket No. 93-251.

for inbound and outbound services to the required interLATA and manufacturing affiliates cannot be characterized as anything other than a fundamental change in the affiliate transaction rules.

A. The Commission Should Not Eliminate the Prevailing Price Valuation Method.

It is beyond comprehension why the Commission wishes to eliminate the prevailing price valuation method for transactions with the required interLATA and manufacturing affiliates.[66] Based upon an ample record in CC Docket No. 86-111, the Commission concluded that a generally available price for a service or product sold by a carrier or its affiliate would be a reliable surrogate valuation method in lieu of fully distributed costs, whether that generally available price is in a tariff or otherwise held out to the public in the normal course of business.[67] If a tariffed rate is still a valid method for affiliate services, then it is unclear why a generally available price established in transactions "at arm's length" between willing buyers and willing sellers should not also continue to be a valid method. The Commission did not even go that far in the Affiliate Transaction NPRM and that was before the 1996 Act instructed the Commission to ease the burden of unnecessary regulation.

Elimination of the prevailing price method is inconsistent with the legitimate logic of continuing to rely upon tariffed rates. If a substantial number of unaffiliated parties are willing and able to purchase services in the open market at a generally available price, that is the highest

---

[66] The NPRM primarily discusses its proposed changes to the affiliate transaction rules in the context of Section 272. Thus, the discussion of these proposals in these Comments is also generally limited to the Section 272 context. SBC recognizes that the NPRM also proposes to apply these changes under Sections 273 and 274. NPRM, ¶¶97, 105.

[67] Joint Cost Order, ¶ 285.

form of protection against any possible cross-subsidy -- using the free market as the frame of reference. Neither the affiliate nor the LEC will control the prevailing price because an independent buyer on the open market can freely choose to purchase from a less expensive supplier if the price is too high. Given the procompetitive goals of the 1996 Act, it would be entirely consistent to allow LEC affiliate sales to be recorded at prices determined by that competitive market.

Elimination of prevailing price forces the valuation process into the more cumbersome tier of determining fully distributed cost, and, in addition, under the NPRM's other proposed change to the affiliate transaction rules, use of estimated fair market value studies in the case of services. This is clearly more burdensome and regulatory compared to the existing rules. The NPRM does not refer to any evidence in the last three years that justifies the change in its position compared to its tentative conclusions in the Affiliate Transaction NPRM, in which it proposed to retain the prevailing price method with some modifications. The most significant change in the last three years is that the 1996 Act now requires the Commission to eliminate unnecessarily burdensome regulations. Forcing LECs to use fully distributed costs when tariff-like publicly available prices are available clashes with the 1996 Act and is unsupported by any substantial public interest reasons or evidence. As an example of the impact of eliminating the prevailing price method, LECs would be required to conduct fully distributed cost studies of an affiliate, even if all of the products and services purchased from that affiliate were available to the public at a prevailing price. There is no justification to impose this additional regulatory burden when the existing rules provide a reliable method of determining the value of the affiliate transaction.

The NPRM indicates that the proposed changes to the affiliate transaction rules are needed in order to be consistent with the requirement in Section 272(b)(5) that the required interLATA and manufacturing affiliates "conduct all transactions with the Bell operating companies . . . on an arm's length basis." SBC believes this is reading far too much into the term "arm's length basis." The 1996 Act did not instruct the Commission to adopt more stringent, burdensome accounting safeguards, nor did it instruct the Commission to adopt stricter affiliate transaction rules. The Affiliate Transaction NPRM has been public information for three years, and yet, there is nothing in the 1996 Act or in its legislative history indicating that Congress expected the Commission to adopt the more onerous proposals made in the Affiliate Transaction NPRM in order to satisfy the requirements of the new law. In fact, elimination of prevailing price is inconsistent with the "arm's length" language of Section 272(b)(5) because prevailing prices are in fact determined based on arm's length transactions with unaffiliated purchasers of the LEC or LEC affiliate products and services. Allowing LECs to use a less burdensome method such as prevailing price is also consistent with the deregulatory objectives of the 1996 Act.

The Commission's reasons for proposing to eliminate the prevailing price method are the same reasons that it provided almost three years ago for proposing to narrow the use of the prevailing price method. These same arguments presented by SWBT and other commenters in response to the Affiliate Transaction NPRM refute the NPRM's current proposal to eliminate prevailing price entirely.[68] The reason provided by the Commission in 1993 and in this NPRM

---

[68] See, e.g., Ameritech Comments at 19-21; BellSouth Comments at 20-22; Cincinnati Bell Comments at 2-4; GTE Comments at 11-13; NYNEX Comments at 24-26; SNET Comments at 7-8; Sprint Comments at 6-10; SWBT Comments at 9-12; US WEST Comments at

for restricting or eliminating the prevailing price method is that the Commission believes that affiliate and nonaffiliate transactions are different in nature. According to the NPRM, nonaffiliate transactions "do not require extensive marketing efforts and involve lower transactional costs than sales to non-affiliates."[69] For example, the Commission appears to believe that sales between affiliates do not require the supplier to "devote significant resources to retaining and attracting customers including sales presentations, advertising campaigns, discounts for volume purchases, or long-term commitments."[70] The reasoning of the NPRM fails to consider that affiliates always have the option of buying the service from an affiliate, buying the service from a nonaffiliate, or producing the service internally. A rational affiliate is not going to purchase the service from an affiliate if the supplying affiliate's prices are materially higher or if its terms and conditions are materially less favorable or attractive compared to an outside supplier. The purchase decision will be driven by what is best for the business and budget of the affiliate. Given that the services in question are available generally to the public, the various incidental transactions that accompany a sale would not suddenly disappear merely because an affiliate is involved in the purchase. The seller must still perform the selling, servicing and warranty activities, regardless of affiliation with the purchaser.

In fact, if the Commission is concerned about any "microscopic" differences between the costs incurred in sales to affiliates versus sales to the general public, the additional costs incurred in complying with the Commission's affiliate rules must also be considered, given that these

---

17-21; USTA Comments at 18-20 in Affiliate Transaction NPRM, CC Docket No. 93-251, filed December 10, 1993.

[69] NPRM, ¶80.

[70] Id., ¶ 80.

costs are not incurred in connection with sales to the general public. The Commission should not attempt to micro-manage the sales process between affiliates when nonaffiliated sales transactions are available as a reliable comparison. Instead, the Commission should review the record collected almost three years ago in CC Docket No. 93-251, which supports retention of the prevailing price method and abandon this part of its efforts to fundamentally alter and increase the burden of its affiliate transactions rules.[71]

The proposal to drop prevailing price is conceptually inconsistent with the proposal to add estimated fair market value to the valuation of services. On the one hand, the NPRM proposes to eliminate an objective method that is based on actual transactions involving the same services provided by the same affiliate, and on the other, the NPRM proposes to superimpose a subjective determination of fair market value presumably based upon a review of reasonably comparable transactions (if any are available) between wholly unrelated parties. The Commission should not eliminate the objective prevailing price test, nor should it make its regulations more intrusive by the addition of the subjective estimated fair market value test.

---

[71] In contrast to the approach in this NPRM, the Commission adopted a somewhat more flexible approach in adopting a presumption approach to the reasonableness of open video system carriage rates, which is analogous to a prevailing price method. The Commission concluded that if "one-third of the system's capacity is leased to one or more unaffiliated programming providers as a group, there is sufficient reason to believe that the rates charged to those providers is reasonable." Implementation of Section 302 of the Telecommunications Act; Open Video Systems, CS Docket No. 96-46, Second Report and Order, FCC 96-249, released June 3, 1996, at ¶122, recon., Third Report and Order and Second Order on Reconsideration, released August 8, 1996. Although the issue of OVS carriage rates is quite different from the affiliate transaction rules, it is significant that the Commission decided to rely upon prices charged by the OVS operator in the open market for OVS carriage as a basis for determining the reasonableness of the carriage rates. The Commission should similarly recognize the value of the LEC or affiliate prevailing market prices for purposes of the affiliate transaction rules.

B. The Commission Should Not Add An Extra Step in The Valuation of Affiliate Services by Requiring Subjective, Burdensome Estimated Fair Market Value Studies.

Without addressing the comments in the record in CC Docket No. 93-251, the NPRM proposes to superimpose an additional valuation procedure on top of the fully distributed cost studies required for nontariffed services not available at a prevailing price. In so doing, the NPRM proposes to require an estimated fair market value study, in addition to the fully distributed cost study, for each and every such service provided between the BOC and the required interLATA and manufacturing affiliates. Almost three years ago, SWBT and the industry opposed the imposition of such an additional estimated fair market value step proposed in the Affiliate Transaction NPRM and provided detailed arguments why this proposed change should not be adopted. In making virtually the same proposal in this NPRM, the Commission has not addressed any of the arguments made by commenters regarding the issue almost three years ago in the Affiliate Transaction NPRM.[72] SBC refers the Commission to the SWBT Comments and other industry comments in the record in that proceeding and respectfully asks that the Commission address the CC Docket No. 93-251 comments in the context of this proceeding.

Using the same reason contained in the Affiliate Transaction NPRM almost three years ago, the NPRM states that this change is needed because allowing carriers to use fully

[72] See, e.g., Ameritech Comments at 12-19; Bell Atlantic Comments at 6 & n.10; BellSouth Comments at 10-12, 16-17, 25; Cincinnati Bell Comments at 5; NYNEX Comments at 15-20; Pactel Comments at 13-15; 17; Sprint Comments at 11-21; SWBT Comments at 13-31; US WEST Comments at 10-15; USTA Comments at 9-10, 20-21 in Affiliate Transaction NPRM, CC Docket No. 93-251, filed December 10, 1993.

distributed cost alone "may reward a carrier's imprudent acts of buying services for more than, and selling services for less than, fair market value."[73] In actuality, there is no such reward, especially for price cap carriers not subject to sharing obligations. On the contrary, the affiliate transaction rules over-allocate costs to the nonregulated affiliates because they are asymmetrical.[74] In fact, the addition of estimated fair market value adds another layer of asymmetrical valuation. It is particularly difficult to understand why the existing affiliate transaction rules that were adequate under rate-of-return regulation where there was a direct link between costs and prices suddenly become inadequate under a price cap regime designed to sever that link. Under a price cap regime, LECs are not able to raise the prices of regulated services. Also, competitive pressure on regulated services make any such "imprudent acts" an imprudent business strategy. Thus, it is not likely that a LEC would pay a nonregulated affiliate more than fair market value because the most likely outcome is that the LEC would suffer lower earnings and/or suffer competitive losses.[75]

The NPRM does not provide any additional reasons for imposing this additional regulatory hurdle. When this proposal was originally made in the Affiliate Transaction NPRM, the Commission did not find any evidence at all to support its belief that carrier's imprudent acts were being rewarded. Neither does this NPRM provide any evidence to support the imposition of this additional regulation.

---

[73] NPRM, ¶ 77.

[74] Joint Cost Recon Order, ¶99.

[75] Further, an affiliate operating in a nonregulated competitive market has prices that are determined by that market. A LEC purchasing service from that affiliate has no incentive to overpay for an inferior service and the market would not allow an affiliate to overprice its services.

If anything, this proposal, like the elimination of the objective prevailing price method, will weaken rather than enhance the affiliate transaction rules. The adoption of an estimated fair market value test for services "is fraught with the potential for abuse, and would be difficult to monitor."[76] At least, that was the Commission's belief when it first rejected use of fair market value for services in CC Docket No. 86-111. The Commission was correct then and it is unclear why the Commission proposes an about-face on this issue.

The adoption of fair market value will degrade the clarity of current rules at a time when clarity is all the more important. The NPRM's proposal will result in endless discussion of what constitutes the fair market value for a multitude of services, including shared administrative services provided between a LEC and its required interLATA and manufacturing affiliates. The Commission recognized this when it observed that "determination of fair market value raises concerns of subjectivity."[77] This is particularly true of services, and even more true of the types of intracorporate services shared among a holding company and its affiliates. The Commission previously concluded that, in contrast to using an estimate of fair market value, by requiring carriers and their affiliates to allocate costs pursuant to the cost allocation rules, "we can ensure that an auditable measure of the cost of service is available."[78] Other valuation methods generally can be verified by reference to objective criteria and carrier or affiliate records; whereas, surveys of potential suppliers and even independent appraisals would become the subject of endless debate among auditors and other experts. Substantial LEC and Commission

---

[76] Joint Cost Recon Order, ¶131.

[77] Joint Cost Order, ¶ 291.

[78] Joint Cost Recon Order, ¶ 131.

resources would be spent arguing over the results of the LECs' estimated fair market valuations. This would occur, for example, because estimated fair market value, assuming comparable services even exist in the marketplace, will at best produce a range of prices, from which the LEC must then select the best estimate. The result will be a regulatory quagmire into which industry and Commission resources would be poured. Finally, the costs incurred in performing such valuations cannot be justified by the minimal theoretical benefits the Commission hopes to obtain.[79]

The NPRM claims that this change also has the alleged advantage of "reduc[ing] the incentive to record an affiliate transaction as a provision of a service, rather than an asset transfer, especially in the context of procurement activities."[80] If the problem to be addressed is the distinction between transfer of an asset and provision of a service, a simpler, less burdensome alternative would be for the Commission to provide clear and simple guidelines as to what is considered an asset transfer.

The Commission should stick to its original position adopted in CC Docket No. 86-111 that a fair market value test is not appropriate for services. As the Commission reviews the record in this proceeding, it should review carefully the comments in the record in CC Docket No. 93-251, which refute in detail the weak reasons for imposing the additional costs of this regulatory requirement.

The NPRM asks whether the more stringent accounting safeguards discussed in this NPRM should apply to all affiliates or only to those affiliates required by the 1996 Act. SBC's

---

[79] USTA Comments, CC Docket No. 93-251, filed December 10, 1993, at 10.

[80] NPRM, ¶ 78.

position is that there should be only one set of nonstructural accounting rules, and that set of rules should be those currently in effect, not any modified rules discussed in the NPRM. The only true changes required by the 1996 Act with regard to affiliates are the separation and other requirements expressly set forth in the statute which are being addressed in the two non-accounting safeguard rulemakings. The existing cost allocation and affiliate transaction rules are more than sufficient as accounting safeguards under the 1996 Act, and thus, it is not necessary for the Commission to decide to whom its revised rules should apply. Assuming, however, that the Commission determines that it will adopt more detailed or stringent accounting safeguards at the conclusion of this proceeding, those modified accounting safeguards should only apply to those affiliates that are required to be separate by the 1996 Act, especially in view of the fact that the NPRM relies, albeit inappropriately, on provisions in Sections 271 through 274 for its determination to consider these changes.

C. The Commission Should Not Adopt Rules Concerning the Methods Used to Determine Estimated Fair Market Value of Assets.

SBC concurs with the Commission's proposal to continue allowing good faith attempts to determine fair market value for asset transfers for purposes of the affiliate transaction rules. The Commission is correct in not attempting to prescribe methodologies for estimating fair market value. Further, it would not be productive for the Commission to adopt guidelines or criteria for determining fair market value of assets. The value of assets can be more readily determined. The Commission should not impose any further detail in its regulation of affiliate asset transfers.

D. Interconnection Rates Determined Pursuant to Section 252 Should Be Available as a Method of Determining Prevailing Price For Affiliates.

The NPRM asks whether interconnection agreements and statements of terms and conditions pursuant to Section 252 would require any changes in the affiliate transaction rules. LECs should be allowed to use the rates contained in such agreements and statements as the basis to establish a prevailing price for a comparable transaction or package entered into with an affiliate. Section 252 does not require any changes in the affiliate transaction rules. Rather, the prevailing price method of the affiliate transaction rules can be applied using the generally available terms and conditions contained in such agreements and statements. Such use of the rates determined pursuant to Section 252 is consistent with the existing affiliate transaction rules. If there is an applicable tariff or tariff-like rate, it should apply to the affiliate purchase of that service; otherwise, the rates charged pursuant to Section 252 should be usable in substantiating a prevailing price for a comparable affiliate purchase. Section 252(i) requires LECs to "make available any interconnection, service or network element provided under any agreement approved under this section to which it is a party to any other requesting telecommunications carrier upon the same terms and conditions as those provided in the agreement."[81] Therefore, the terms and conditions in such agreements would be generally available to any telecommunications carrier, and should be no less available to a telecommunications carrier affiliated with a LEC. Since the terms and conditions of such agreements would be generally available to telecommunications carriers, those terms and conditions would constitute the

[81] 47 U.S.C. §252(i).

prevailing price for such a transaction between the LEC and its affiliate.[82] SBC concurs with the Commission's proposal to use the prescribed interstate rate of return as the return component in the computation of fully distributed costs of nontariffed services not available at a prevailing price in transactions between a BOC and the affiliates required by the 1996 Act.

IX. THE AFFILIATE TRANSACTION RULES ARE MORE THAN SUFFICIENT FOR TRANSACTIONS BETWEEN A BOC AND ITS INTERLATA AFFILIATE.

In CC Docket No. 86-111, the Commission determined that the affiliate transaction rules are not applicable between two regulated affiliates because they are unnecessary.[83] Admittedly, Section 272 does require that all transactions between a BOC and its required interLATA affiliate be at arm's length and imposes other straightforward requirements for the required interLATA affiliate. While implementation of these provisions of Section 272 does not require the Commission to adopt any special accounting rules, compliance with the existing affiliate transaction rules in the limited context of a BOC's transactions with its required interLATA affiliate certainly would assure that the BOC is going beyond what is required to comply with

---

[82] The First Report and Order in CC Docket No. 96-98 has mandated the use of Total Element ("TE") incremental cost studies for the purpose of establishing rates for unbundled network elements. Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, FCC 96-325, released August 8, 1996, ¶¶674-703. These cost studies will be the basis for charging interconnectors to utilize LEC network elements for provision of local service. If the Commission entertains a departure from existing affiliate transaction rules, the Commission should permit LECs to use such TE incremental cost studies as an alternative method in accounting for affiliate transactions. It would be very inconsistent to charge interconnector customers based upon incremental cost studies while accounting for affiliate customer charges based upon fully distributed cost.

[83] Joint Cost Recon Order, ¶108.

the arm's length and other transactional requirements of Section 272. The existing affiliate transaction rules should only be applied in this context to the extent strictly necessary.

The Commission need not adopt "special valuation methodologies" for transactions between a BOC and its required interLATA affiliate. The standard affiliate transaction rules are more than sufficient to prevent cross-subsidy in such transactions.

X. THE AFFILIATE TRANSACTION RULES FULLY SATISFY THE "ARM'S LENGTH" REQUIREMENT OF SECTION 272(d)(5).

The NPRM describes certain Computer Inquiry II requirements that applied to AT&T's provision of enhanced services and the customer premises equipment in the early 1980s and asked whether the Commission "should adopt similar requirements to implement Section 272(d)(5)." It would be improper to construe "arm's length basis" in Section 272(d)(5) to require the Commission to revert to a system of regulation that existed in the early 1980's, and in so doing, to ignore the evolution of regulation, legislation and competition in the telecommunications industry. The system to which this NPRM suggestion would revert were the structural separation requirements that predated the Computer Inquiry III nonstructural accounting safeguards, including the affiliate transaction rules. Superimposition of all or any part of this Computer Inquiry II structural separation system would be entirely redundant and, in fact, harmful, given that the nonstructural accounting safeguards of Computer Inquiry III replaced the structural separation requirements of Computer Inquiry II.[84]

[84] SBC addresses the impropriety of reverting to Computer Inquiry II safeguards in its comments in CC Docket No. 96-149. See SBC Comments, CC Docket No. 96-149, filed August 15, 1996 at 6, 11-17.

The NPRM focuses particularly on the Computer Inquiry II requirement that prices be compensatory in connection with transfers of products between the enhanced services/CPE separate subsidiary and the affiliated equipment manufacturer. Besides being redundant in the current system of regulation, the current affiliate transaction rules provide much more meaning to the phrase "arm's length" than ever provided by the old "compensatory price" standard. Under Computer Inquiry II, the requirement that prices be compensatory simply meant that the transfer between the manufacturing entity and the enhanced service/CPE affiliate had to be at full cost, including reasonable profit, overhead and transaction cost.

The affiliate transaction rules and the fully distributed costing method of the Joint Cost Order provide a much more detailed definition of the transfer price required for an arm's length transaction between regulated and nonregulated affiliates. The affiliate transaction rules provide several valuation methods, each of which is appropriate for a particular type of transaction. For example, if the transaction involves a tariffed product, the tariff rate makes much more sense than merely requiring that the price be "compensatory." Similarly, when an affiliate sells a product from a price list or at a price generally available to the public, use of the price it charges most other parties makes much more sense, and is much simpler, than requiring that the carrier book an amount determined by a study of the costs incurred by the affiliate. Finally, the fully distributed cost valuation method includes a hierarchy of cost allocation principles which is much more detailed than the Computer Inquiry II "compensatory price" standard. It would be redundant and inconsistent to superimpose the outdated standard of the early 1980s in lieu of or on top of the affiliate transaction rules, which are abundantly sufficient in and of themselves.